

1. Concepts and Elements of Business Environment

1.1 Introduction of Business Environment

Business

In common sense, the term business refers to buying and selling of goods. But in modern times, business covers a wide and complex field of industry and commerce involving complex activities related to both production and distribution. All these activities satisfy the diverse needs of the society and also help to generate profit of business firms or units.

Thus by the term business we mean organized efforts of different enterprises for supplying various goods and services to the ultimate consumers for a profit. **Business, in nutshell, includes diverse activities related to production, marketing, transport, trade, finance, banking, insurance, advertising and some other activities connected with industry and commerce.**

Environment

The term environment includes all external forces which have an important bearing of the functioning of the business. According to Barry M. Richman and Melvyn Copen, "Environment factors or constraints tire largely if not totally, external and beyond the control of individual industrial enterprises and their managements. These are essentially the 'givers' within which firms and their managements must operate in a specific country and they vary, often greatly from country to country."

'Business Environment'

"Business Environment encompasses the 'climate' or set of conditions, economic, social, political or institutional in which business operations are Conducted."

-Arthur M. Weimer

"Environment contains the external factors that create opportunities and threats to the business. This includes socio-economic conditions, technology and political conditions."

- William Gluck and Jauch

"Business environment is the aggregate of all conditions, events and influences that surround and affect it."

- Keith Davis

"The environment of business consists of all those external things to which it is exposed and by which it may be influenced directly or indirectly".

- Reinecke and Schoell

"The total of all things external to firms and industries that affect the function of the organisation is called business environment."

- Wheeler

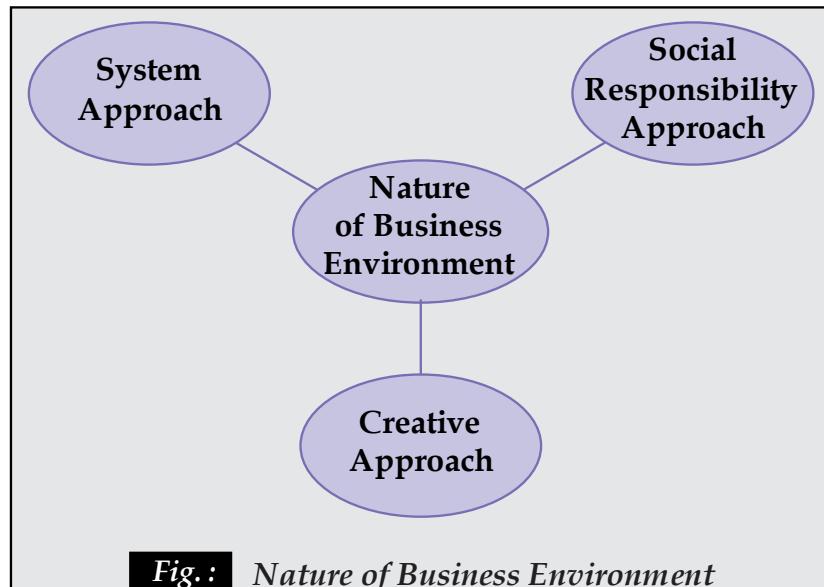
"Civilisations require challenges to survive. Thus environment also contains hostilities and dangers that may be overcome by individuals and organisations."

- Arnold J. Toynbee

On the basis of the above definitions, it is very clear that the business environment is a mixture of complex, dynamic and uncontrollable external factors within which a business is to be operated.

1.2 Nature of Business Environment

The nature of Business Environment is simply and better explained by the following approaches :



- (i) **System Approach** : In original, business is a system by which it produces goods and services for the satisfaction of wants, by using several inputs, such as, raw material, capital, labour etc. from the environment.
- (ii) **Social Responsibility Approach** : In this approach business should fulfill its responsibility towards several categories of the society such as consumers, stockholders, employees, government etc.
- (iii) **Creative Approach** : As per this approach, business gives shape to the environment by facing the challenges and availing the opportunities in time. The business brings about changes in the society by giving attention to the needs of the people.

1.3 Significance of Business Environment

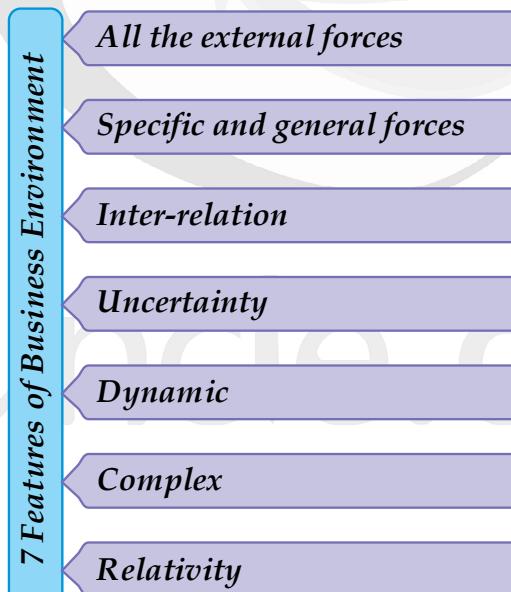


Business Environment refers to the "Sum of conditions which surround man at a given point in space and time. In the past, the environment of man consisted of only the physical aspects of the planet Earth (air, water and land) and the biotic communities. But in due course of time and advancement of society, man extended his environment through his social, economic and political function."

In a globalised economy, the business environment plays an important role in almost all business enterprises. The significance of business environment is explained with the help of the following points:

- (i) **Help to understand internal Environment :** It is very much important for business enterprise to understand its internal environment, such as business policy, organisation structure etc. In such case an effective management information system will help to predict the business environmental changes.
- (ii) **Help to Understand Economic System :** The different kinds of economic systems influence the business in different ways. It is essential for a businessman and business firm to know about the role of capitalists, socialist and mixed economy.
- (iii) **Help to Understand Economic Policy :** Economic policy has its own importance in business environment and it has an important place in business. The business environment helps to understand government policies such as, export-import policy, price policy; monetary policy, foreign exchange policy, industrial policy etc. have much effect on business.
- (iv) **Help to Understand Market Conditions :** It is necessary for an enterprise to have the knowledge of market structure and changes taking place in it. The knowledge about increase and decrease in demand, supply, monopolistic practices, government participation in business etc., is necessary for an enterprise.

1.4 Features of Business Environment

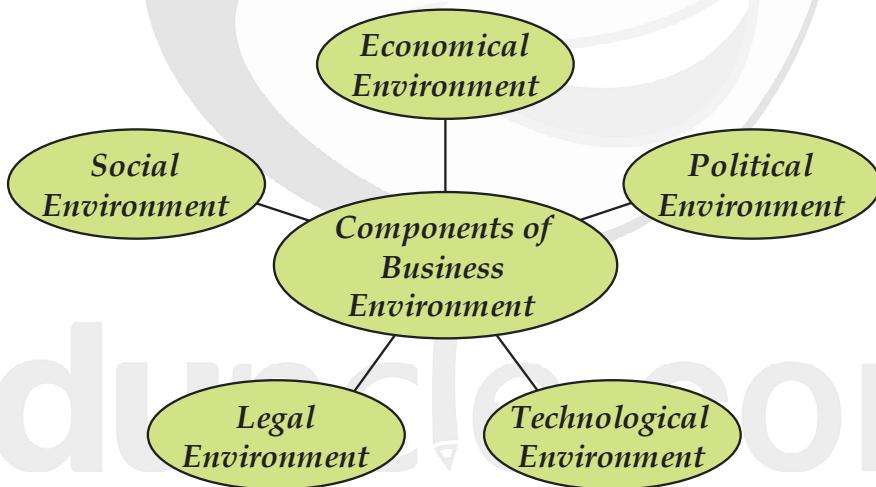


The main features of business environment are :

- (i) **All the external forces :** Business Environment includes all the forces, institutions and factors which directly or indirectly affect the Business Organizations.

- (ii) **Specific and general forces** : Business environment includes specific forces such as investors, customers, competitors and suppliers. Non-human or general forces are Social, Legal, Technological, Political, etc. which affect the Business indirectly.
- (iii) **Inter-relation** : All the forces and factors of Business Environment are inter-related to each other. For example with inclination of youth towards western culture, the demand for fast food is increasing.
- (iv) **Uncertainty** : It is very difficult to predict the changes of Business Environment. As environment is changing very fast for example in IT, fashion industry frequent and fast changes are taking place.
- (v) **Dynamic** : Business environment is highly flexible and keep changing. It is not static or rigid that is why it is essential to monitor and scan the business environment continuously.
- (vi) **Complex** : It is very difficult to understand the impact of Business environment on the companies. Although it is easy to scan the environment but it is very difficult to know how these changes will influence Business decisions. Some-time change may be minor but it might have large impact. For example, a change in government policy to increase the tax rate by 5% may affect the income of company by large amount.
- (vii) **Relativity** : The impact of Business environment may differ from company to company or country to country. For example, when consumer organisation CES published the report of finding pesticides in cold drinks, resulted in decrease in sale of cold drinks, on the other hand it increased the sale of juice and other drinks.

1.5 Major Components of Business Environment



The major components of a good business environment are listed below:

Dimensions of business environment mean all the factors, forces and institutions which have direct or indirect influence over the business transactions.

General Environment is the most important dimension of business environment as businessman cannot influence or change the components of general environment rather he has to change his plans and policies according to the changes taking place in general environment.

(i) Economical Environment : *Economic Environment consists of Gross Domestic Product, Income level at national level and per capita level, Profit earning rate, Productivity and Employment rate, Industrial, monetary and fiscal policy of the government etc.*

The economic environment factors have immediate and direct impact on the businessman so businessmen must scan the economic environment and take timely actions to deal with these environments. Economic environment may put constraints and may offer opportunities to the businessman. After the new economic policy of 1991, lots of opportunities are offered to businessmen. The common factors which have influenced the Indian economic environment are :

- (a) *Banking sector reform has led to many attractive schemes of deposits and lending money. The Banks are offering loans at very nominal rate of interest and with minimum formalities to be completed.*
- (b) *Recent changes in economic and fiscal policy of country have encouraged NRIs and foreign investors to invest in Indian companies.*
- (c) *Lots of economic reforms are taking place in leasing and financing institutions. The private sector is allowed to enter in financial institutions; as a result customers are gaining.*

Some Aspects of Economic Environment:

- (a) Role of Private and Public sector
- (b) Rate of growth of GDP, GNP, and Per Capita Income
- (c) Rate of Saving and Investment
- (d) Balance of Trade
- (e) Balance of Payment
- (f) Transport and Communication System
- (g) Money Supply in the Economy
- (h) International Debt

(ii) Social Environment : *Social Environment consists of the customs and traditions of the society in which business is existing. It includes the standard of living, taste, preferences and education level of the people living in the society where business exists.*

The businessman cannot overlook the components of social environment as these components may not have immediate impact on the business but in the long run the social environment has great impact on the business.

For example, when the Pepsi Cola Company used the slogan of "Come Alive" in their advertisement then the people of a particular region misinterpreted the word "Come Alive" as they assumed it means Coming out of Graves. So, they condemned the use of the product and there was no demand of Pepsi Cola in that region. So, the company had to change its advertisement slogan as it cannot survive in market by ignoring the sentiments of the people.

In India also, there are many Social reforms taking place and the common factors of Indian Social Environment are:

- (a) *Demand for reservation in jobs for minority and women*
- (b) *Demand for equal status of women by paying equal wages for male and female workers*
- (c) *Demand for automatic machines and luxury items in middle class families*
- (d) *The social movements to improve the education level of girl child.*
- (e) *Health and Fitness trend has become popular.*

Some Aspects of Social Environment :

- a. Quality of life
- b. Importance or place of women in workforce
- c. Birth and Death rates
- d. Attitude of customers towards innovation, life style etc.
- e. Education and literacy rates
- f. Consumption habits
- g. Population
- h. Tradition, customs and habits of people

(iii) Political Environment : *Political environment constitutes all the factors related to government affairs such as type of government in power, attitude of government towards different groups of societies, policy changes implemented by different governments etc. The political environment has immediate and great impact on the business transactions so businessman must scan this environment very carefully.*

The businessman has to make changes in his organisation according to the changing factor of political environment. For example, in 1977 when Janata Government came in power they made the policy of sending back all the foreign companies. As a result the Coca Cola Company had to close its business and leave the country.

The common factors and forces which have influenced the Indian political environment are :

- (a) *The government in Hyderabad is taking keen interest in boosting I.T. industry, as a result the state is more commonly known as Cyberabad instead of Hyderabad.*
- (b) *After the economic policy of liberalisation and globalisation, the foreign companies got easy entry in India. As a result the Coca Cola which was sent back in 1977 came back to India. Along with Coca Cola, Pepsi Cola and many other foreign companies are establishing their business in India.*

Some Aspects of Political Environment :

- a. Present political system
- b. Constitution of the country
- c. Profile of political leaders
- d. Government intervention in business
- e. Foreign policy of government
- f. Values and ideology of political parties

(iv) Legal Environment : *Legal environment constitutes the laws and various legislations passed in the parliament. The businessman cannot overlook the legislations because he has to perform his business transactions within the framework of legal environment.*

The common legislation passed which has affected the business transactions are Trade Mark Act, Essential Commodity Act, Weights and Measures Act, etc. Most of the time legal environments put constraints on the businessman but sometimes they provide opportunities also. The common instances of Indian legal environment which have influenced business transactions recently are:

1. *Deregulation of capital market has made it easy for businessman to collect capital from primary market.*
2. *Removal of control from the foreign exchange and liberalisation in investment is encouraging foreign investors and NRIs to invest in Indian capital market.*
3. *Advertisement of alcoholic product is prohibited.*
4. *Compulsory to give statutory warning in Tobacco production.*
5. *Delicensing policy of industries.*

Some Aspects of Legal Environment :

- a. Various laws and legislative acts.
- b. Legal policies related to licensing.
- c. Legal policies related to foreign trade.
- d. Statutory warnings essential to be printed on label.
- e. Foreign Exchange Regulation and Management Act.
- d. Laws to keep a check on Advertisements.

(v) Technological Environment : *Technological environment refers to changes taking place in the method of production, use of new equipment and machineries to improve, the quality of product. The businessman must closely monitor the technological changes taking place in his industry because he will have to implement these changes to remain in the competitive market.*

Technological changes always bring quality improvement and more benefits for customers. The recent technological changes of Indian market are:

1. *Digital watches have killed the prospects and the business of traditional watches.*
2. *Color T.V. technology has closed the business of black and white T.V.*
3. *Artificial fabric has taken the market of traditional cotton and silk fabrics.*
4. *Photo copier and Xerox machines have led to the closure of carbon paper business.*
5. *Shift in Demand from vacuum tubes to transistors.*
6. *Shift from steam locomotives to diesel and electric engine.*
7. *From typewriter to Word Processors.*

Some Aspects of Technological Environment :

- a. Various Innovations and Inventions.
- b. Scientific Improvements.
- c. Developments in IT sector

- d. Import and Export of Technology.
- e. Technological Advances in Computers.

Ques. Match the items of List-I with the items of List-II and select the correct answer.

List-I	List-II
(a) Political and Legal Environment	(i) Important for industries directly depending on imports or exports.
(b) Demographic Environment	(ii) Close relationship with the economic system and economic policy.
(c) Economic Environment	(iii) Related to natural resources.
(d) Geographical and Ecological Environment	(iv) Occupational and spatial mobility of population having implications for business.

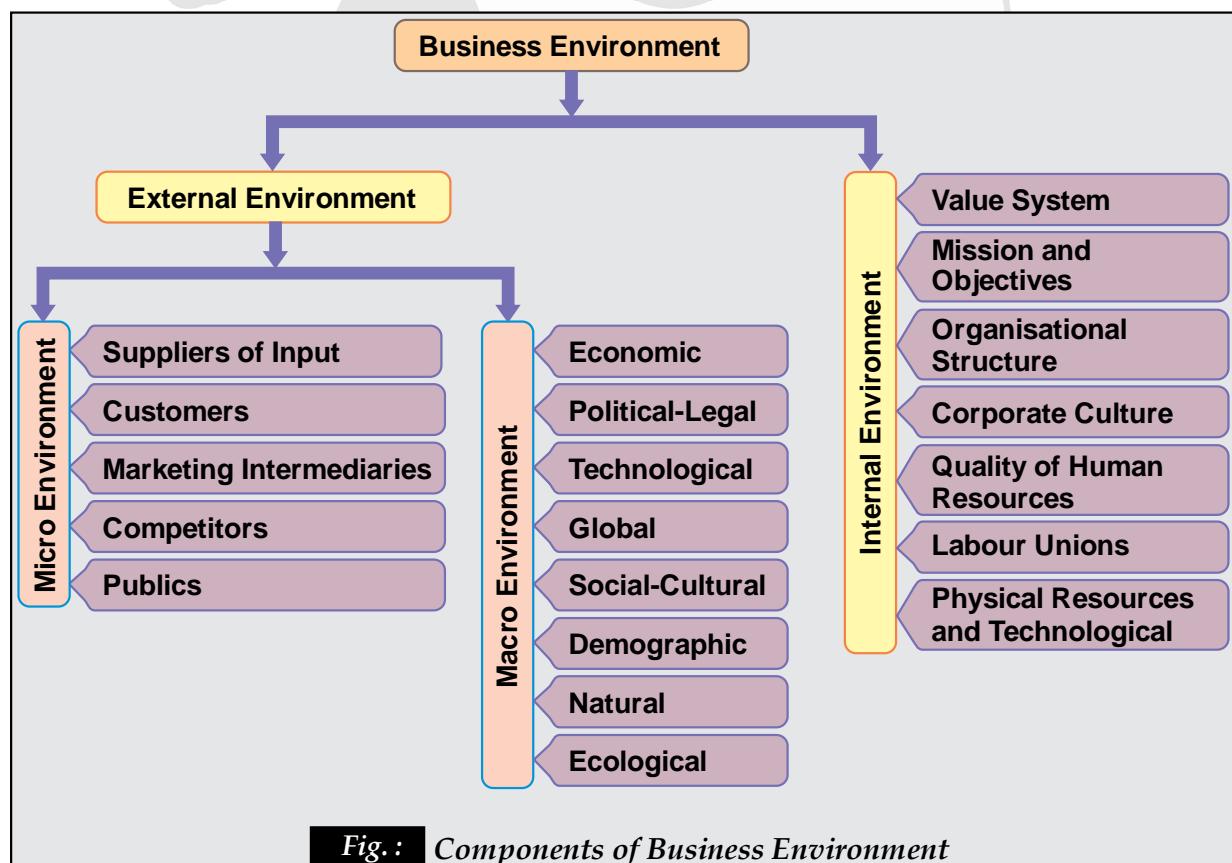
Codes :

	(a)	(b)	(c)	(d)
(A)	(ii)	(iv)	(iii)	(i)
(B)	(ii)	(iv)	(i)	(iii)
(C)	(i)	(ii)	(iii)	(iv)
(D)	(i)	(ii)	(iv)	(iii)

Ans. (B) (ii) (iv) (i) (iii)

(NTA UGC-NET June 2013 P-III)

1.6 Types of Business Environment



(i) External Environment : *External environment consists of those factors that affect a business enterprise from outside. External environment includes shareholders, competitors, customers, society, government laws and regulations, policies and technology.* External environment is generally classified into micro environment and macro environment. We will explain below micro and macro types of external environment of business. Different players in the micro environment normally do not affect all the companies of a particular industry in a similar way. However, sometimes micro environment of the various firms of an industry remains almost same.

(A) External Micro-Environment

Micro environment includes those players whose decisions and actions have a direct impact on the company. **Production and selling of commodities are the two important aspects of modern business.** The various constituents of micro environment are as under:

- (a) Suppliers of Inputs :** An important factor in the external micro environment of a firm is the supplier of its inputs such as raw materials and components.
- (b) Customers :** The people who buy and use a firm's product and services are an important part of external micro environment. Since sales of a product or service is critical for a firm's survival and growth, it is necessary to keep the customers satisfied.
- (c) Marketing Intermediaries :** In the firm's external micro environment, marketing intermediaries play an essential role of selling and distributing its products to the final customers. Marketing is an important link between a business firm and its ultimate customers.
- (d) Competitors :** Different firms in an industry compete with each other for sale of their products. This competition may be on the basis of pricing of their products and also non- price competition through competitive advertising such as sponsoring some events to promote the sale of different varieties and models of their products.
- (e) Publics :** Finally, publics are an important force in external micro environment. Public, according to Philip Kotler, "is any group that has an actual or potential interest in or impact on the company's ability to achieve its objective." Environmentalists, media groups, women's associations, consumer protection groups, local groups, citizens association are some important examples of publics which have an important bearing on the business decisions of the firm.

(B) External Macro Environment

Apart from micro environment, business firms face large external environmental forces. **An important fact about external macro environmental forces is that they are uncontrollable by the management.** Because of the uncontrollable nature of macro forces a firm has to adjust or adapt it to these external forces. These factors are:

(a) Economic Environment : Economic environment includes all those forces which have an economic impact on business. **Accordingly, total economic environment consists of agriculture, industrial production, infrastructure, and planning, basic economic philosophy, stages of economic development, trade cycles, national income, per capita income, savings, money supply, price level and population.**

(b) Political-Legal Environment : *The political-legal environment includes the activities of three political institutions, namely, legislature, executive and judiciary which usually play a useful role in shaping, directing, developing and controlling business activities. In order to attain a meaningful business growth, a stable and dynamic political-legal environment is very important.*

(c) Technological Environment : *Technology implies systematic application of scientific or other organised knowledge to practical tasks or activities. Business makes it possible for technology to reach the people in proper format. As technology is changing fast, businessmen should keep a close look on those technological changes for its adaptation in their business activities.*

(d) Global or International Environment : The Global environment plays an important role in shaping business activity. With the liberalisation and globalisation of the economy, business environment of an economy has become totally different wherein it has to bear all shocks and benefits arising out of global environment.

(e) Socio-Cultural Environment : Finally, the social and cultural environment also influences the business environment indirectly. These includes people's attitude to work and wealth, ethical issues, role of family, marriage, religion and education and also social responsiveness of business.

(f) Demographic Environment : *The demographic environment includes the size and growth of population, life expectancy of the people, rural-urban distribution of population, the technological skills and educational levels of labour force. All these demographic features have an important bearing on the functioning of business firms.*

(g) Natural Environment : The Natural environment influences business in diverse ways. The natural environment is the ultimate source of many inputs such as raw materials and energy, which firms use in their productive activity. In fact, the availability of natural resources in the region or country is the basic factor in determining business activity in it. The natural environment which includes geographical and ecological factors such as minerals and oil reserves, water and forest resources, weather and climatic conditions and port facilities are all highly significant for various business activities. For example, steel producing industries are set up near the coalmines to save cost of transporting coal to distant locations. The natural environment also affects the demand for goods. For example, in places where temperatures are high the demand for coolers and air conditioners are high. Similarly, weather and climatic conditions influence the demand pattern for clothing, building materials for housing etc. Natural calamities like floods, droughts, earthquake etc. are devastating for business activities.

(h) Ecological Environment : Due to the efforts of environmentalists and international organisations such as the World Bank the people have now become conscious of the adverse effects of depletion of exhaustible natural resources and pollution of environment by business activity. Accordingly, laws have been passed for conservation of natural resources and prevention of environment pollution. These laws have imposed additional responsibilities and costs for business firms.

(ii) Internal Environment : *The factors in internal environment of business are to a certain extent controllable because the firm can change or modify these factors to improve its efficiency. However, the firm may not be able to change all the factors.*

The various internal factors are :

- (a) **Value System** : *The value system of an organisation means the ethical beliefs that guide the organisation in achieving its mission and objectives.* It is a widely acknowledged fact that the extent to which the value system is shared by all in the organisation is an important factor contributing to its success.
- (b) **Mission and Objectives** : *The business domain of the company, direction of development, business philosophy, business policy etc are guided by the mission and objectives of the company.* The objective of all firms is assumed to be maximisation of profit. Mission is defined as the overall purpose or reason for its existence which guides and influences its business decision and economic activities.
- (c) **Organisation Structure** : *The organisational structure, the composition of the board of directors, the professionalism of management etc are important factors influencing business decisions.* An efficient working of a business organisation requires that the organisation structure should be conducive for quick decision-making.
- (d) **Corporate Culture** : Corporate culture is an important factor for determining the internal environment of any company. In a closed and threatening type of corporate culture the business decisions are taken by top level managers while the middle level and lower level managers have no say in business decision making. This leads to lack of trust and confidence among subordinate officials of the company and secrecy pervades throughout the organisation. This results in a sense of alienation among the lower level managers and workers of the company. In an open and participating culture, business decisions are taken by the lower level managers and top management has a high degree of confidence in the subordinates.
- (e) **Quality of Human Resources** : Quality of employees that is of human resources of a firm is an important factor of internal environment of a firm. The characteristics of the human resources like skill, quality, capabilities, attitude and commitment of its employees etc could contribute to the strength and weaknesses of an organisation. Some organisations find it difficult to carry out restructuring or modernisation plans because of resistance by its employees.
- (f) **Labour Unions** : *Labour unions collectively bargains with the managers for better wages and better working conditions of the different categories of workers etc.* For the smooth working of a business firm good relation between management and labour union is required.
- (g) **Physical Resources and Technological Capabilities** : Physical resources such as plant and equipment and technological capabilities of a firm determine its competitive strength which is an important factor for determining its efficiency and unit cost of production. Research and development capabilities of a company determine its ability to introduce innovations which enhances productivity of workers.

Ques. Which one of the following is not an element of internal environment ?

(NTA UGC-NET Dec. 2012 P-III)

(A) <i>Mission/Objectives</i>	(B) <i>Human Resources</i>
(C) <i>Customers</i>	(D) <i>labour unions</i>

Ans. (C) *Customers are the element of external environment.*

Ques. Which among the following is not a correct sequential combination ?

(NTA UGC-NET Dec. 2014 P-II)

- (A) *Macro Environment → Economic Environment → National Income → Pattern of Income Distribution*
- (B) *Business Environment → Internal Environment → Business Ethics → Payment of Fair Wages*
- (C) *Business Environment → External Environment → Micro Environment → Suppliers*
- (D) *Macro Environment → External Environment → Customers Prospects of Business Development*

Ans. (D) *Macro Environment → External Environment → Customers Prospects of Business Development*



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